RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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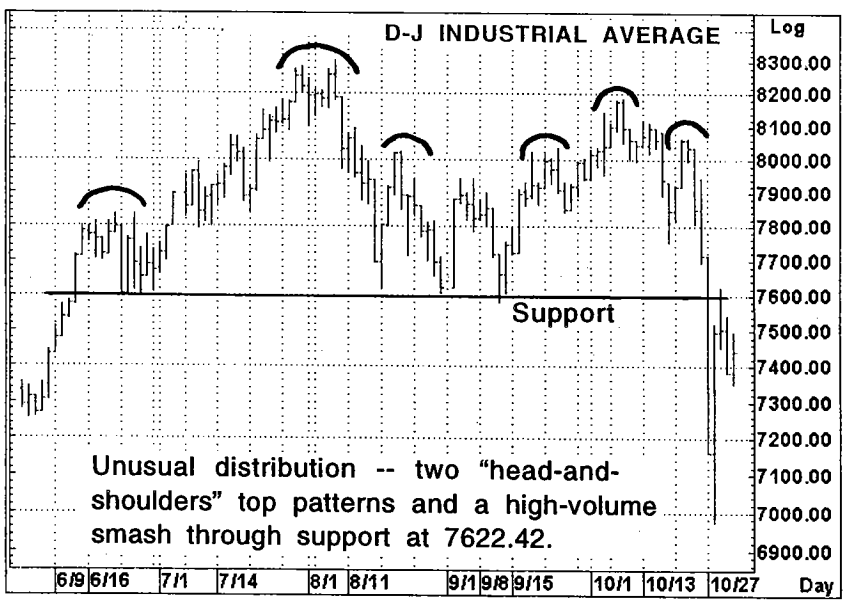
Nov. 5, 1997 **LETTER 1238**

Oct. 24 DJIA 7715.41; PTI 5098; A-D Ratio +9.93
Oct. 31 DJIA 7442.08; PTI 5104; A-D Ratio +9.47
Dow Yield: 1.80%; Dow Price/Earnings: 19.2
Dow 144-day MA: 7612; Dow 34-day MA: 7798
Dow Times Book Value: 5.26; PTI 89-day MA: 5035
Percentage of Undervalued Blue-chips: 3%
Gold 144-day MA: 336

START: I'm going to try to tell the market story with the help of two main charts. So here goes.

First chart: Here we see a "head-and-shoulders" pattern having formed during the July-August period. This topping pattern broke down, and by August 29 the Dow registered a reaction (closing) low of **7622.42.** From the August 29 low a second advance took place, and a second head-and-shoulders pattern was formed -- this time the peak of the head-and-shoulders pattern occurred **below** the peak of the previous head-and-shoulders pattern. I stated in the last Letter that I "never like this type of formation."



Thus, we had **two successive distribution patterns.** Following the second distribution pattern, the market turned down again, and on October 27 the Dow smashed below its August 29 reaction low of 7622.42. The Dow closed that day (Aug. 29) at 7161.15. The October 27 action can best be described as a "mini-crash."

The following day on huge (1.2 billion) shares, the Dow surged back to close at 7498.32. So in record-breaking volume the market came back, but the Dow nevertheless closed well below the previous "breaking point" of 7622.42. Interestingly, on that huge volume day there were only 20 new highs and 300 new lows. Again interestingly, the advance-decline figures showed 1835 issues up and 1342 issues down. Those 1342 issues down implied a lot of selling, despite the over 300 point recovery in the Dow.

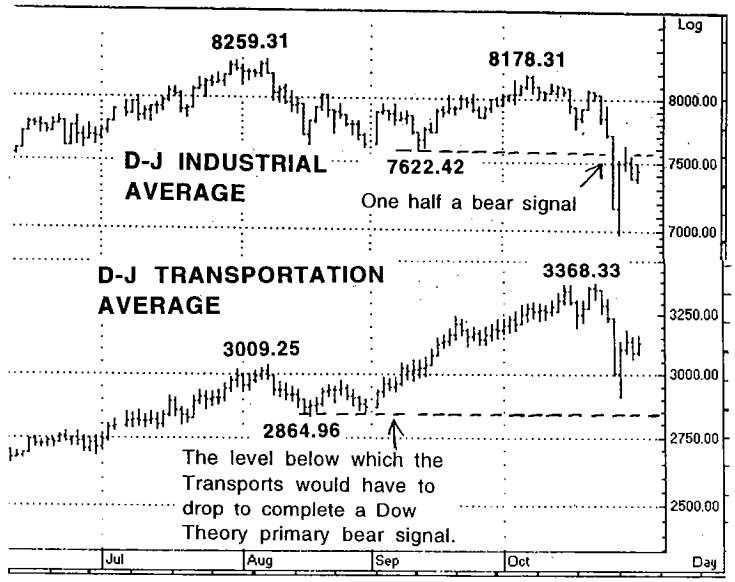
DOW THEORY: Second chart: Let me preface this section -- it's absolutely amazing and ominous that **nobody (no analyst that I have heard of)** has seen or understood that the market is now poised for a **potential Dow Theory bear market signal.** It hasn't happened yet, but the market pattern is set up for a potential bear signal.

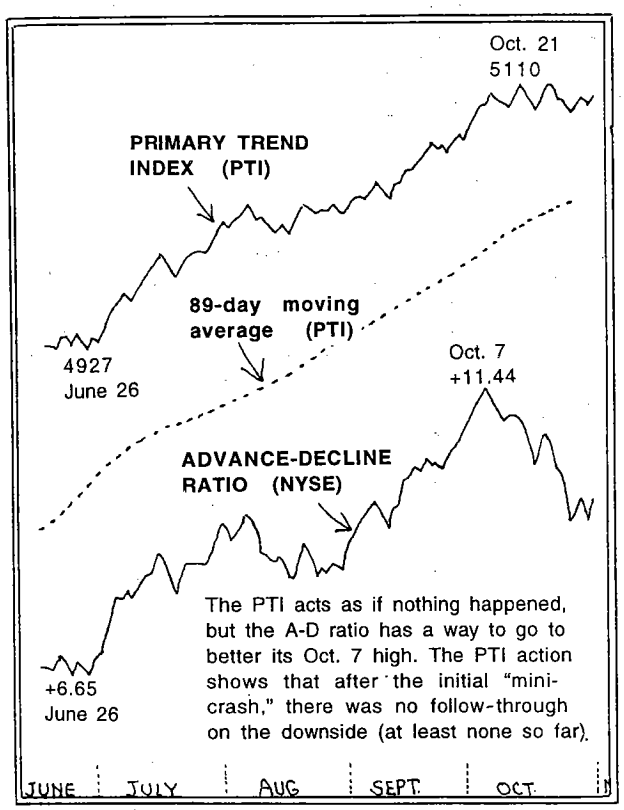
Now, here's the correct Dow Theory interpretation (refer to chart). The Dow recorded a high of 8259.31 on August 6. The Transports continued to register new highs, but the new Transport highs were **not confirmed by the Dow.** Then, in early October the Dow turned down, and on October 27 the Dow violated its August 29 reaction low of 7622.42 on huge volume. The Transports **did not confirm** the Industrial violation of its August 29 low (the Aug. 29 Dow low was 7622.42).

The comparable Transportation low was the August 15 low-close of **2864.96. IF, on any forthcoming decline, the Transports break below their own 2864.96 low, thereby confirming the prior violation by Industrials, a primary bear market will be signaled under Dow Theory.** Until then, the direction of the primary trend of the market is unclear (although technically the trend remains bullish simply because a bear market has not yet been signaled).

Dow Theory Conclusion: The Dow has delivered only one-half of a bear signal, and half a bear signal is no better than none. It's **now up to the Transports** to either confirm or deny that a bear market has started. So -- until we see new highs by both Industrials and Transports or until we see a new Transportation low -- we're going to be in a **trading range,** a range which, in the past, I've called "no-man's land."

Further Comment: As seen on chart #2, there were two major distributions in the Dow, the whole distributive process having **started in mid-June.**





What could change that would take the Dow, despite all that distribution, to new highs? My opinion -- I sincerely doubt that the conditions which caused informed investors to distribute the big Dow stocks from June through October have changed. For that reason, I don't think we're going to see new highs in the Dow. There's just been **too much distribution.**

THE BIG PICTURE: Prior to the recent "market weakness" I heard stories of people cutting back on the family food budget, scrimping on clothing, taking out second mortgages on their homes -- all in a frantic effort to put more of their weekly or monthly wages into the stock market. So I really do have to call the public's love affair with the stock market a mania.

America's Consuming Love Affair With Stocks

By James L. Tyson
Staff writer of The Christian Science Monitor

WASHINGTON

ANY anxieties Americans may have felt about the Crash of '87 didn't last long.

lion, according to the Federal Reserve.

That Conde Naste study also shows strong confidence in the market, despite reminders of Black Monday. About 60 percent in the survey said they did not expect big declines this year or next

will rebound quickly like it did in 19 Shiller. "But that idea is not necessa - the market has been down in 1 eight years," he says.

The overwhelming question: vestors abandon the buy-and-hold s

OK, all the above is what I call the external picture, or what you've seen yourself when you visited your local boardroom or when you picked up your local newspaper. But what is so fascinating to me is what the stock market did over the past few weeks in the face of all this passion for stocks.

For one thing, the Dow ceased to participate on the upside ever since August 6. Despite huge infusions of public money (over $21 billion in September), despite frothy optimism on the part of Wall Street and Main Street, the Dow, as this is written, is still 700 points under its August 6 high.

What was the recently collapsing market telling us? Here are a few of the possibilities that the bulls are putting forth: **(1)** The Dow was simply "backing off," waiting for profits to catch up to prices. **(2)** Stocks rose too rapidly during 1996-97 and they finally gave us "the long-overdue correction of better than 10%." **(3)** The whole market sell-off was triggered by "foreign problems" but the US economy continues to be solid. **(4)** This is a "mini-replay" of 1987, and the decline has provided us with another great buying opportunity.

Then there is the bears' view: **(1)** The Dow, for over three months has **refused to confirm** the Transports or the other major averages. The reason is that the growth rate in earnings is declining, and next year's earnings projections will not materialize. The bears see vicious competition from overseas and a world battle for exports, a battle that is now impacting on US stocks. **(2)** Buyers and sellers of the big Dow stocks tend to be an extremely sophisticated group. They see what's happening in Japan and Southeast Asia, and they're worried that the US is in line to catch the "Asian flu." **(3)** Stock prices have advanced in a bull market that has been in force for 23 years (since 1974). Knowledgeable investors believe that the bull market has shown unmistakable signs of old age, meaning that a full-fledged bear market is long overdue. **(4)** The public has continued to pour their earnings and savings into the market, even while insiders were heavily selling. The market's upside momentum has reversed. Big money is moving to the exits.

BACKGROUND: All during 1997 the wise men have been informing us of the marvels of the global economy. And yes, the global economy is here, and yes, it may well be a marvel. And all year (actually for the last few years) the wise men have been telling us about the "huge potential demand" that lies dormant in China and Asia. Fascinating, but I kept saying that China and Asia would more likely be a **source of supply** than demand.

In 1994 China, wanting to boost its exports, devalued its currency, and the trouble began. Cheap Chinese exports killed the Southeast Asian economies. The first to unravel was Thailand. In order to compete, Thailand devalued its currency, and then competitive devaluations became the name of the game as one by one the rest of Southeast Asia followed suit.

Stage #2 -- pressure hit Hong Kong, and of course Hong Kong is now part of China. Will China (with rising unemployment and huge excess manufacturing capacity) devalue again? Will there be another round of Asian devaluations? We'll see.

So the amazing global economy is here, and the implications of the global economy, both good and bad, are just beginning to be realized. Consider this -- 20 years ago Thailand could have sunk into the ocean, and it wouldn't have made a blip on the NYSE or on US consciousness. Today, things are very, very different. Today every nation is in the battle for world position and world exports, and what happens to the Thai bhat or what happens to the yen or the D-mark has a lot to do with what happens here in the US.

Meanwhile, the US stock market did what it always does when it's confused and seeking protection. It backs off. But there's a problem, and it's one that even the gurus of Wall Street are reluctant to mention. The problem is that based on the duration of this bull market, based on extreme overvaluation, based on public participation, a primary bear market is long overdue. Could this be the beginning? Can't tell yet.

And I have to wonder -- is the current Asian mess just a cover-up for much larger problems? Under the guise of "overseas problems," is the bear beginning to stir?

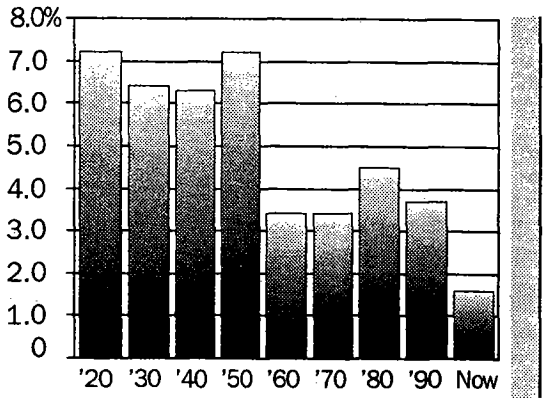
FIGURES: You hear a lot of talk about how the Dow has done, percentage-wise over the years. The figure most often used is that the Dow has provided a compound return of 10% since 1925. Most people are under the impression that this represents pure appreciation. Not so. If that Dow had actually increased by 10% a year it would now be more than 150,000.

No, that 10% that is so-often quoted assumes that all Dow dividends paid over the years had been re-invested -- the other assumption is that no taxes were paid on those dividends. The current Dow level of around 8000 means that the Dow itself has actually appreciated on average about 5.6% a year. The difference, the big difference, is the addition and compounding effect of **dividends**.

The current dividend yield on the Dow is 1.7%. This is close to the lowest dividend yield in history. But today's investors don't mind; they don't mind because they've enjoyed the abnormal price appreciation during recent years. However, if the market stalls out here and moves into a trading range or bear market, investors will suddenly become aware that the dividend yield has practically disappeared. Of course, if a bear market should materialize, the downside could be much worse than "normal" because there is no dividend yield to cushion the decline.

So it's important to note that millions of amateur investors have entered the stock market based on the much-talked-about thesis that the stock market will provide at least a 10% return over coming years. They don't realize that the 10% return is a product of two functions -- average appreciation and compounding dividends. But the second part, the dividend part, has literally disappeared in today's market.

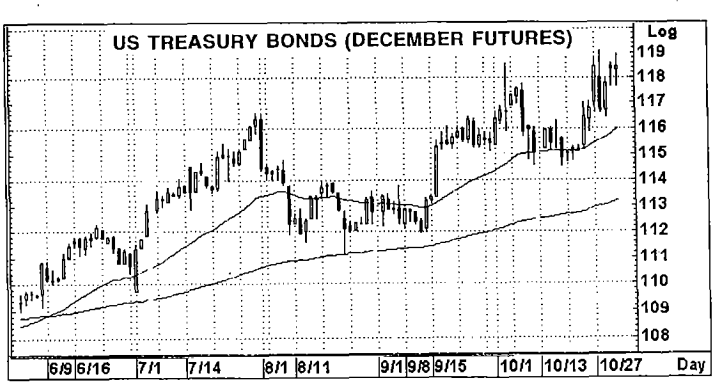
This chart will help to illustrate the above comments. Here we see the year-end dividend yield for the S&P 500 on an end-of-the-decade basis going back to 1920.



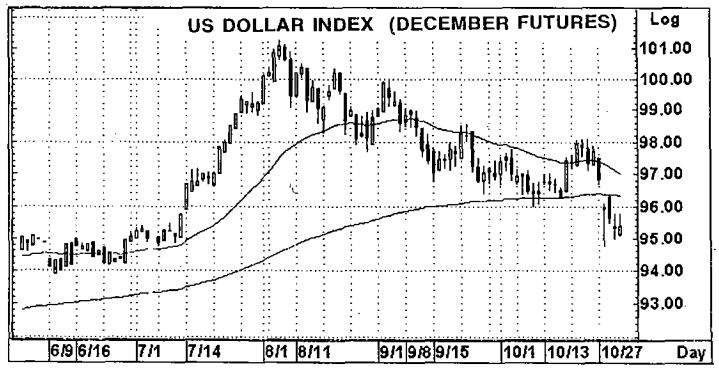
Question: How can we determine whether deflation is hitting the US economy?

Answer: The best way is this -- if deflation hits, corporate profits will suffer and consequently stocks will go down. By the same token, if deflation hits, stocks and bonds will part directions **and bonds will rally** (since in a deflation high-grade bonds will continue to pay interest, and in a deflation a fixed rate of guaranteed income is worth increasingly MORE).

BONDS, DOLLARS: The mystery deepens. I've been recommending Treasury bonds, and so far the T-bonds have done very well, as you can see via this daily chart of the December T-bond futures. Here we see the December bond futures flirting with their high for the year -- the high close occurred on October 27 at 118 25/32nds. That's about half a point above where the bonds are now. Note how powerful the 34-day moving average is as it pulls away from the longer-term 144-day MA.



Now the mystery is how the bonds can be so strong with the US dollar so weak? Here we see the dollar plunging first below its 34-day MA and then (last week) below its 144-day MA.



What's the story? My only thought is this -- the bonds are strong because Americans are buying them as a safe haven from the stock market (and most Americans don't realize that the dollar topped out on August 6, the exact day that the Dow topped out).

On the other hand, somebody is selling dollars. My thought here is that with currencies across the globe devaluing, investors and traders see coming pressure on US exports and coming pressure on the dollar. After all, if all the Asian currencies devalue, traders may feel that the dollar too will come under pressure. It makes sense, but sense or not, it's happening.

INVESTMENT POSITION: The bull is still in the box, but he's developed a case of the palsy (characterized by uncontrollable shaking and white hooves, probably brought on by fear). My OPINION is that the bull is in trouble, but as long as the Transports hold above 2864.96 I have to call the primary trend bullish.

There has been noticeable market deterioration. I now count 13 of the 30 Dow stocks as definitely bearish, based on their positions below BOTH moving averages. The 13 are Allied Chem, Alcoa, Boeing, Coke, DuPont, Kodak, McDonald's, Merck, Philip Morris, Sears, Johnson & Johnson, Union Carbide, and United Technologies. If and when 16 or more Dow stocks turn definitely bearish, the market could accelerate on the downside.

I continue to like the bonds, but even here I would hedge, meaning one-third to one-half in the long T-bonds and the rest in short T-notes or T-bills. This is no time to be a hero, this is the time to avoid losses. And yes, I am aware that most of the "experts" on CNBC are calling this a "great buying opportunity." We'll see, won't we?

NOTES & QUOTES: Clinton and his officials have reversed themselves on the plans to "reform" the dreaded IRS. Even Secretary Rubin, the leading critic of the reform plan, announced that the reform plan "is a workable plan that we can support." Why the change in heart on the part of the Dems? Easy, they note that the Republicans will run on a platform of a totally new tax system in the coming elections (flat tax or consumption tax and dump the IRS) -- and the Dems figure that tidying up the IRS will derail the GOP's plan to get rid of the entire current tax system.

Of course, the presidential candidate who will be running on the flat tax ticket will be **Steve Forbes**, my choice to succeed Clinton. Forbes stole the show at the Indianapolis roll call of GOP presidential hopefuls last August. Forbes, formerly a dull speaker, has jazzed up his delivery and comes on as sincere, well-informed and highly intelligent.

* *

The Administration proudly announces that the US deficit this year will be "only $22 billion," and they predict a coming surplus. So already, the pols are arguing about how to spend the surplus. They would do well to wait. The latest figure on the national debt is $5.421 trillion. Exactly 12 months ago the figure was $5.232 trillion. This means that we have added $189 billion to the national debt over the past year. But wait -- it gets worse. Roughly $81 billion from the plus side was taken from Social Security. And about $100 billion on the plus side came from the big tax take due to the boom in corporate taxes. **Russell prediction**: The deficit is due to grow again.

* *

One of the most "accepted" theses today is that a bear market cannot occur unless interest rates are rising. Maybe. But it pays to beware of **conventional wisdom.** It is notable that the collapse of currencies, stock markets and economies in Thailand and most of Southeast Asia came without any tightening of interest rates or, for that matter, without any particular dramatic event. What then precipitated the Southeastern Asia collapse (and Japan's cave-in as well)? The answer -- excesses, crazy high prices, over-speculation -- in short, irrational exuberance.

* *

The Richebacher Letter [(561)279-0957], which has taken a dim view of what is happening in the US, believes that business here is heading for a profit squeeze. Why? The Richebacher reasoning -- "lack of pricing power, lack of productivity growth, and rising wage pressure."

* *

La Jolla is evidently becoming the heart and center of good feelings and wisdom. The current guru of choice, Deepak Chopra, has opened his center right here in the heart of La Jolla. Deepak made the cover of the Oct. 20 Newsweek. The magazine, in a feature article, terms Deepak (sarcastically, I would guess) the "Bearer of True Enlightenment." On top of that, Tony Robbins also lives here, and in fact, I caught tall Tony (he's about six foot five) and his tiny wife munching sandwiches at my favorite outdoor restaurant. Robbins is a fabulously successful speaker and espouser of the "you can change your life and live up to your potential" school. One way a lot of people are changing their external lives is by moving to La Jolla. When I moved to La Jolla in 1967 it was a quiet (very quiet), boring, beautiful little town in which absolutely nothing was happening -- at night only two places were open, a supermarket and a bar with a lovely fireplace called the Bratskeller. Today the town is a booming upscale resort town flooded with tourists from all over the world. Strolling down the main street at night you can hear as many as 15 different languages. Things change, times change, and everything in life is a trade-off. The old, charming, boring La Jolla is gone; the new, interesting, cosmopolitan La Jolla is here. It's crowded and parking spots are at a premium and time marches on.

* *

The Cable Guy: What does **Microsoft** want? It wants or would like to dominate the forthcoming TV/Internet business. Gates evidently sees the whole picture moving from PC in the office to TV/Internet in the living room. To do this, MSFT wants to get into cable, and that's just what it's doing. Let me put it another way, Gates wants to build a second huge business around delivery of Windows-based software and interactive services to home consumers. So far, a lot of people are not really using the Internet. Why? It's slow, they don't know how to use it, or else the whole subject seems too complicated for them to comprehend. To be successful, interactive TV must be cheap, fascinating and very, very simple. And that's where cable comes in. Cable is 100 times faster than most modems; coaxial cable runs past 95% of American homes; cable accommodates huge quantities of data, and cable is where Gates is heading. Gates is not just buying cable stocks, he's hoping to influence cable firms' choice of software that will run the next generation of TVs. But cable companies will resist orders from Gates; they don't want to be under the thumb of Bully Bill.

Meanwhile the Justice Dept. is slapping the monopoly and restraint of trade label on Microsoft, claiming it's forcing PCs to carry its Internet entrance stuff. Here in San Diego, they've formed SPOGGE (rhymes with rogue) or the Society for the Prevention of Gates Getting Everything. In an October 22 editorial the *WSJ* tells Justice to stop wasting its time pestering Gates and get on to important things. Note: MSFT makes $4 million a day. The government threatens to fine MSFT $1 million a day. MSFT might figure that $1 million a day is just a cost of doing business.

* *

English is the accepted international language of business. The Internet originated in the US and the language of the Internet is English. These two are forcing most of the world to learn English, although certain countries such as France resent this. Already there are computer programs which can translate (roughly) English into other languages, but English has really become the international language. Let me put it this way -- today, if you don't speak English, you're at a big disadvantage.

* *

Tired of fighting **traffic?** Who isn't? Here's the latest list of the best and worst traffic-congested cities.

Most congested cities:
1. Los Angeles
2. Washington, D.C.
3. San Francisco-Oakland
4. Miami
5. Chicago
6. Seattle-Everett
7. Detroit
8. San Diego
9. San Bernardino-Riverside
10. Atlanta

Least congested cities:
1. Corpus Christi, Texas
2. El Paso, Texas
3. Kansas City, Mo.
4. Pittsburgh, Pa.
5. Oklahoma City
6. Orlando, Fla.
7. San Antonio and Indianapolis (tie)
8. Norfolk, Va. and Hartford, Conn. (tie)

— *The Associated Press*

Ah, where to move to? How about a state with no income tax? Here they are -- Alaska (brrrr), Florida (damn those mosquitoes), Nevada (heat, where's the grass?), Texas (if it's Austin or San Antonio), S. Dakota (I'm freezing), Washington (gad, it's raining again) and Wyoming (those long, frozen winters). Tennessee and New Hampshire don't tax earned income, but they do tax interest and dividends. The hot city now is Seattle. Everybody I know wants to move to Seattle. Maybe they just want to be near Bill Gates. The hot states are Colorado, Washington, Oregon. And people keep pouring into California, the state that has it all, including high taxes (for me, there's no place like Southern California).

* *

The Oct. 19 (Sunday) *NY Times* included a feature article in which nine pros offered their ideas on whether there would ever be another 1987-type crash. Opinions were split, but I thought the best answer was given by G. Kenneth Heebner, brilliant manger of the CGM Capital Development Fund, one of the top funds of '97. Of course, one of the reason I like Heebner's opinion is that it corresponds closely with my own. Here it is: "If we have a big market decline, it will happen slowly, not suddenly like it did in 1987. Since then, confidence has grown enormously that stock prices will always bounce back. The depth of that conviction will not be destroyed in a short period of time. In the last big market decline, it took five years, from 1969 to 1974, for the mood to go from euphoria to despair. Plus, we've now set up a whole new industry of investment advisers, which has created a process of looking at Morningstar reports and selecting a five-star fund. That has given mutual fund investors a perception of safety and protection -- which, in reality, isn't there."

* *

The Oct. 9 *Women's Wear Daily* talks about the retail building boom in **Shanghai**. "Fashion retailing is growing up in China, and, as befits the former Paris of the Orient, Shanghai intends to lead the scene." **Russell comment:** Better believe it. Last week I talked to two Hong Kong businessmen who had just arrived at the US on a selling trip. I asked them how things were in Hong Kong and if there were any changes since the Chinese took over. They told me that very little had changed, that there was no pressure from the Chinese -- BUT, they both felt that the coming place, the city that the Chinese wanted as the new center of China was not Hong Kong but Shanghai. Therefore, they were surprisingly unexcited about the future of Hong Kong.

* *

Speaking of cities, when I left **New York** in 1961 one million people were involved with manufacturing (garments, furs,

printing). Today only 250,000 New Yorkers are involved with manufacturing (the manufacturing base has moved either to other cities or overseas). New York has been enjoying a boom, but the boom has largely been a result of the Wall Street bull market plus a build-up in retail, business services, media, insurance and finance (all the latter involved to a large extent with Wall Street). Patrick Howie, an economist at Regional Financial Assoc. estimates that the cost of doing business in NYC is 29% above the national average and more than 40% above the average in Sun Belt cities like Houston, Dallas or Oklahoma City. **Russell comment:** When a bear market finally comes in, NYC, which is so dependent on Wall Street's profits, is going to be a very tough place to live in. During the last recession, for instance, the City lost 180,000 manufacturing jobs. NYC is a place where there is strong demand for skilled workers and weak demand for the unskilled. Two-thirds of the growth in wages since NYC's recovery has been in financial services.

* *

It looks as though the **Euro**, Europe's forthcoming single currency, is going to happen -- definitely. The fear was that with the addition of the Portuguese escudo, the Spanish peseta and maybe the Italian lira, the Euro would start off as a weak currency. But this perception is changing. This is exactly the thinking of the majority of Germans, who remain reluctant to give up their much-loved D-mark. However, whatever happens it is certain that the Germans (hard money) will have a strong hand in the new central bank which will control Europe's finances. Furthermore, consider this -- the Euro will be backed by the world's second largest economic zone after the dollar, by vast combined foreign-exchange reserves, by a higher savings rate than the US, and unlike the US, by a growing current account surplus. Therefore, a shocker could be that the Euro will be stronger than the dollar.

As for dollars, this chart, courtesy of World Money Analyst [(561)279-0957] shows you what various **currencies** will buy compared with a dollar. For instance, in Moscow goods sell 41% cheaper than in the US, while in Japan the same goods would cost 52% more.

PURCHASING POWER PARITIES

Country	City	Exchange Rate	Cheap or PPP*	Expensive
Russia	Moscow	0.00017	0.00029	-41.4%
South Africa	Johannesburg	0.22135	0.34333	-35.5%
Mexico	Mexico City	0.12629	0.18207	-30.6%
Indonesia	Jakarta	0.00041	0.00054	-24.1%
Philippines	Manila	0.03795	0.04919	-22.9%
Venezuela	Caracas	0.00205	0.00262	-21.8%
Thailand	Bangkok	0.03849	0.04587	-16.1%
Malaysia	Kuala Lumpur	0.39963	0.45776	-12.7%
China	Shanghai	0.12068	0.13667	-11.7%
Argentina	Buenos Aires	0.99605	1.12320	-11.3%
Netherlands	Amsterdam	0.51280	0.54803	-6.4%
Brazil	Sao Paolo	0.93795	0.96863	-3.2%
Hong Kong	Hong Kong	0.12919	0.13324	-3.0%
Germany	Frankfurt	0.57524	0.54858	4.9%
France	Paris	0.17090	0.15275	11.9%
England	London	1.64581	1.46160	12.6%
Singapore	Singapore	0.69020	0.56553	22.0%
Switzerland	Zurich	0.68834	0.48894	40.8%
Japan	Tokyo	0.00851	0.00557	52.8%

* *

Deflation: The price of **collectors' cars** has been heading down. Probably the trend-setters in this field are the famous prancing horse autos, the Ferraris. Writes the Oct. 13 issue of *AutoWeek* in an article entitled, "Driving Beats Investing," a fiber glass body '76 308 GTB Ferrari (the ones that used to be $100,000) couldn't get a bid higher than $31,000. The 308s and 328s aren't going anywhere in price -- up or down. They're a lot of used car for the money, but forget about buying one as an investment. The Ferraris to run, not walk, away from are those 1985-1991 12-cylinder Testarossas. A '91 sold at Auburn for $64,000. If their prices keep plummeting, they may soon be cheaper than the 328s, which are currently $45,000." **Russell comment**: Unless you know exactly what you're doing, buying classic cars for appreciation is a very difficult speculation. Ten years ago, the Jaguar XKE's were sky-high in price, many of them selling for as much as $80,000 in prime condition. Today you can buy one for $20,000 as their popularity has diminished greatly.

* *

In my opinion, **Michael Bloomberg** is one of the smartest businessmen and entrepreneurs in the world. Bloomberg is in the magazine business, the TV business and in the information business. His Bloomberg terminals (cost $1,000 a month) now number 77,000, and are in offices throughout the world. Bloomberg says that the Internet and other sources provide information -- Bloomberg and his software shows you how to USE that information. In a recent interview Bloomberg was asked why his new magazine bears his name. He answered, "My immediate answer is, 'Why not?' When I promote one product with the Bloomberg name, I'm automatically promoting every product with the Bloomberg name. As a businessman I've been struck by the power of great franchises, names like Coca Cola and McDonald's. To my mind, building a publishing empire requires the same tactic as building any empire and that involves one constant brand name. It's the common thread that you constantly pound into people's heads. I can't figure out why other companies don't co-brand all their products the same way. It's advertising for all your other products. I'd have named Proctor & Gamble the Ivory Soap Co. You stick with what the public recognizes. When it comes to soap or magazines, they pay the bill." **Russell comment:** Keep your eye on Bloomberg, he's going to be another Bill Gates. Interestingly, his office employees have no titles, no private rooms, no partitions, anybody can talk to anybody. Bloomberg isn't interested in who's above whom, he's interested in ideas and talent.

* *

Last week **Warren Buffett** (Berkshire Hathaway) paid $589 million to buy Dairy Queen's 6,370 soft ice cream stores. It might be a good buy, but I don't like the product. I stopped at the Dairy Queen at Pacific Beach last week and ordered a cup of vanilla. My reaction was ugh, too oily, too much fat, I didn't like it. I guess I'm used to that delicious Southern California brand of non-fat yogurt. Warren, do something about that Dairy Queen stuff -- it tastes like it's made with Vaseline. I understand that before buying Dairy Queen, Buffett patronized the place for more than a year. Warren, switch to non-fat yogurt, I thought you've been looking a bit plump of late.

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Could there be such a thing as an entire nation possessing good Karma? If there is, then little Norway's got it. During the Nazi takeover of most of Europe, **Norway** (which was occupied by the Nazis) was one of the very few countries that refused to turn over its Jews to the Germans. Then, when Hitler dictated that all of Norway's Jews wear the yellow arm-band identifying them as Jews, the King of Norway, King Haakon, defied the Germans -- he wore the Star of David armband himself. Meanwhile, the Norwegian underground fought and harassed the Nazis at every turn.

Time passes. Today Norway, with a population of only 4.5 million, is rich with North Sea Oil. Norway is now the second biggest exporter of oil (after Saudi Arabia) in the world. Norway has a tiny 3.4% unemployment rate, NO national debt, health care is free, education is cheap, housewives are happy since their work accumulates towards government pensions, and record numbers of Norwegians are traveling abroad. The "Norwegian Dream" consists of a house and two summer cottages, one in the mountains and one by the sea. Rich little Norway paid off its international debts in 1994 and balanced its budget the following year. Now Norway runs a fat annual surplus of $10 billion, and its biggest political problem is how to spend the money. Growth in Norway is at 5.3% and inflation is not a problem. The average household's disposable income is $47,000, not great but it buys a lot when you don't have to pay for health care, retirement, or your kids' education. Good Karma? I have to believe that Norway has it.

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OWNERS: Despite what you may think, mutual funds own only 15% of US stocks. Individuals own 46%, retirement funds own 10% and the rest is assorted.

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It's the biggest **embezzlement** in history. Yasuyoshi Kato, chief financial officer of Day-Lee Foods, a California meat-packing

company was living it up, with a $3 million estate and a 250-acre citrus ranch, Armani suits, Ferraris, Tiffany jewelry for his girlfriends and his ex-wife. Where did it all come from? He stole it from his company. He wrote checks to himself from the company's treasury -- until the IRS arrested him. What was his motive? The federal prosecutor summed it up in one word, "Greed."

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In May of '97 the state of Oregon approved a resolution asking Congress for a waiver system to let states opt **out of Social Security** and design their own retirement plans for all workers, public and private. Items: **(1)** If you are in your late thirties today, you will need to save 68.1 years beyond retirement age to recoup the taxes paid to Social Security (plus market interest) over your lifetime. **(2)** If you opt out of SS, you can expect retirement incomes several times that of SS for the same contribution level, and this despite market risk.

LATE NOTES: The big question now is whether Asia's devaluation-deflation scenario is going to be exported to South America and then to the US. Probably, the place to watch is the **Brazilian real**. If the Brazil's real is devalued, then the chances are good that devaluation will sweep across S. America and into Mexico. In which case, the US would be the recipient of an even greater flood of low-priced goods (and many of these goods are high-tech and of excellent quality).

Speaking of **deflation**, here some interesting quotes. "There's a risk of an Asian recession that becomes a world recession. Asia is big enough now to influence world prices and the direction is down." -- Chen Zhao, editor of *China Analyst* . . . "The good news is that the US has been able to continue its relatively high-growth path without inflation because we are importing deflation from Asia. The bad news is that if Asia's excess-supply problem is bad enough, the problems will be transferred to the West." -- John Makin, fellow of the Amer. Enterprise Institute . . . Asia's problem is an obsession with production. Everyone has been investing too much. They sell goods at any price they can get." -- Jesper Koll, economist at JP Morgan . . . "I doubt the devaluations are over. There's no sign that people are really cutting back on capacity. Three to six months from now, we could enter a new deflation cycle." Mr. Courtis of Deutsche Bank . . . "China and Korea are perhaps the worst oversupply culprits, funneling huge investment in industries that already have excess capacity. Stopping the deflationary cycle won't be easy. Countries that devalue their currencies essentially spread deflation like a contagion, forcing other exporters to match lower prices on goods. Asia has yet to feel the full deflationary effect of its latest devaluations. The cycle began in 1994, when China pegged the yuan 35% lower in US dollar terms. Japan soon allowed its yen to crumble against the dollar. Southeast Asia, Taiwan and Korea, their exports skimmed on the low end by China and on the high end by Japan, followed suit, with devaluations ranging from 10% to 30%." -- *WSJ*, Oct. 32.

I've been asked why the **dollar** has been weak ever since early August. My opinion -- the more foreign currencies devalue, the more there will be subtle pressure on the dollar (look at it this way, the cheaper foreign currencies become, the less competitive the dollar appears). Secondly, a lot of foreigners have been taking a recent beating in the US stock market. They sell their US stocks, receive dollars, sell their dollars for yen and D-marks and Swiss francs and ship their own currencies back home.

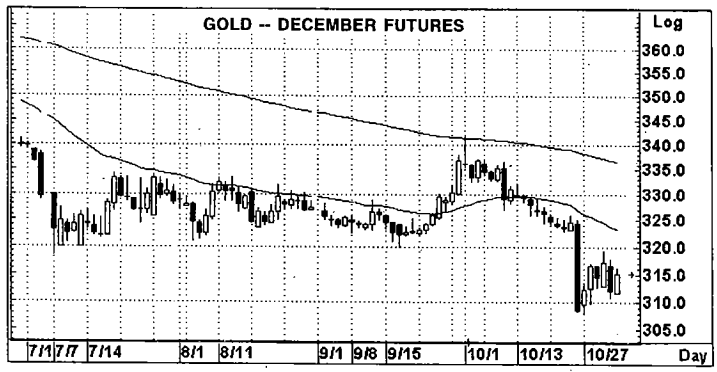
DOW: Newer subscribers may wonder why I place so much emphases on the action of the Dow. No other 30 stocks are so studied, so monitored, so scrutinized as the 30 D-J Industrials. These are the stocks that are bought, sold and analyzed endlessly by big, sophisticated money. Let the Dow move **persistently, on a trend basis,** either up or down, and the rest of the market will invariably follow. So saying, it's important to note that the Dow has been persistently weak ever since its record high of 8259.31 recorded on August 6. That may change, but it hasn't yet.

A TEST: As this is written (Monday), the 144-day MA of the Dow stands at 7612, the 34-day MA stands at 7795. This puts the two MAs 183 points apart. They are converging at the rate of about 22 points a day, which means they could cross in 9 trading days. If they cross (with the 34-day MA dropping below the 144-day MA), that's a bearish indication, but a lot depends on where the Dow is if or when the two moving averages cross.

CONFIDENCE: Each time the stock market smashes (as per last week), and each time the market recovers from a smash, the public gains more confidence and more faith in the concept that the bigger the "dip" the better the buy spot. Eventually, this kind of conditioned-reflex investing will prove to be disastrous, but -- evidently, not yet.

GOLD: There isn't a heck of a lot to say here. So far, gold seems to be reacting to deflationary forces and rumors out of Switzerland, forces which are keeping gold very close to its low (the low on the Dec. futures was 308.30 recorded on Oct. 24).

It's also possible that gold is trying to bottom here, and if so, this is my reasoning as to why gold could be bottoming. If the trend to world deflation continues, every central bank in the world is going to be pumping out its respective currency in an effort to re-inflate. If or when this happens (and, of course, this is what our own Fed did in '87 when the market crashed), there's going to be a heck of a lot of paper floating around the world. The more paper "out there," the more paper it's going to take to buy an ounce of gold. Gold may be looking ahead at the above possibility.



FINAL RUSSELL OPINION -- TRADING RANGE: On last week's mini-crash the Transports gave up remarkably little (see page 1 chart). So we now have a dramatic **downside non-confirmation** on the part of the Transports. At the same time, the Dow has been very resistant to registering new highs (as this is written the Dow is still 670 points below its record high of **8259.31). Best bet: the market lapses into a trading range with Transports refusing to break to new lows and the Dow refusing to advance to new highs.**

There's no question but that we've been living through a super-high volatility area over recent months. But "after the storm comes the calm." If I'm correct, if we are indeed moving into a trading range, then I would also expect volatility to simmer down, maybe even collapse. What would that mean? It could easily mean a period of much lower stock market activity, much smaller price movements and relative calm. It could take a few weeks before entering into this new, calmer mode.

NEXT MAILING: Nov. 19, 1997